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August 24, 1993

Mr. William Caton
Secretary
Federal Communications Commission
Room 222
1919 M Street, NW
Washington, D.C. 20554

Re: In the Matter of: 1993 Annual Access Tariff Filings, Tariffs of Local Exchange Carriers, CC Docket No. 93-193

Dear Mr. Caton,

Enclosed herewith for filing are the original and seven (7) copies of MCI Telecommunications Corporation's Opposition to Direct Cases in the above captioned matter. Please acknowledge receipt by affixing an appropriate notation on the copy of the MCI Petition furnished for such purpose and remit same to the bearer.

Yours truly,

Michael F. Hydock

Michael F. Hydock
Senior Staff Member
Federal Regulatory Analysis

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of:	
1993 Annual Access Tariff Filings **Tariffs of Local Exchange Carriers**	**CC Docket No. 93-193**

Opposition to Direct Cases

MCI TELECOMMUNICATIONS CORPORATION
1801 PENNSYLVANIA AVENUE, N.W.
WASHINGTON, D.C. 20006

August 24, 1993

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SUMMARY

On June 23, 1993, the Common Carrier Bureau released a Memorandum Opinion and Order Suspending Rates and Designating Issues for Investigation regarding issues raised within the 1993 Annual Access Tariff filing. In that order, the Bureau suspended the rates in the annual filing for one day and initiated an investigation into certain issues raised in the annual filing. Carriers were required to file Direct Cases to further explain their treatment of SFAS-106 issues, sharing and lower formula adjustment issues, and a variety of miscellaneous issues.

Within this petition MCI will discuss the treatment of SFAS-106 transition benefit obligations (TBO) accruals, the appropriate mechanism for implementing sharing and low end adjustments for financial reporting, and the understatement of access reductions from U S West's Dial Equipment Minutes (DEM) calculation. For the reasons discussed below, MCI urges the Commission to reject exogenous treatment of SFAS-106 accruals as filed by the LECs in their 1993 Annual Access Tariff Filings. Price cap LECs have not met their burden of proof in demonstrating that they lack control over SFAS-106 TBO accrual costs. Even assuming the LECs could demonstrate the exogeneity of SFAS-106 accruals, they have not met their burden of quantifying the amount of double counting either in the component parts of the price cap formula or the formula as a whole. MCI will also demonstrate that sharing amounts should be added back, and low end adjustments should not be added back, when calculating rates of return. Such a process would mimic the status quo for determining rates of return. Finally, MCI will

show that U S West's direct case has not shown that it has not understated its 1993 DEM exogenous access charge reduction by $5.5 million.

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Opposition to Direct Cases

On June 23, 1993, the Common Carrier Bureau released a Memorandum Opinion and Order Suspending Rates and Designating Issues for Investigation[1] regarding issues raised within the 1993 Annual Access Tariff filing. In that order, the Bureau suspended the rates in the annual filing for one day and initiated an investigation into certain issues raised in the annual filing. Carriers were required to file Direct Cases to further explain their treatment of SFAS-106 issues, sharing and lower formula adjustment issues, and a variety of miscellaneous issues. Herein, MCI provides its opposition to the direct cases filed by certain Local Exchange Carriers (LECs).[2] Within this petition MCI will discuss

[1]In the Matter of 1993 Annual Access Tariff Filings, CC Docket No. 93-193, Memorandum Opinion and Order Suspending Rates and Designating Issues for Investigation, (MO&O) DA 93-762, released June 23, 1993.

[2]Direct Cases of the following LECs are addressed by MCI: Ameritech Operating Companies, the Bell Atlantic Telephone Companies, BellSouth Telecommunications, Inc., NYNEX Telephone Companies, The Pacific Companies, Southwestern Bell Telephone Company, U S West Communications, Inc., GTE Service Corporation and its Affiliated Domestic Telephone Operating Companies, Rochester Telephone Corporation, and

the treatment of SFAS-106 transition benefit obligations (TBO) accruals, the appropriate mechanism for implementing sharing and low end adjustments for financial reporting, and the understatement of access reductions from U S West's Dial Equipment Minutes (DEM) calculation. For the reasons discussed below, MCI urges the Commission to reject exogenous treatment of SFAS-106 accruals as filed by the LECs in their 1993 Annual Access Tariff Filings. Price cap LECs have not met their burden of proof in demonstrating that they lack control over SFAS-106 TBO accrual costs. Even assuming the LECs could demonstrate the exogeneity of SFAS-106 accruals, they have not met their burden of quantifying the amount of double counting either in the component parts of the price cap formula or the formula as a whole. MCI will also demonstrate that sharing amounts should be added back, and low end adjustments should not be added back, when calculating rates of return. Such a process would mimic the status quo for determining rates of return. Finally, MCI will show that U S West's direct case has not shown that it has not understated its 1993 DEM exogenous access charge reduction by $5.5 million.

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the Southern New England Telephone Company.

ISSUE NUMBER 1. HAVE THE LECs BORNE THEIR BURDEN OF DEMONSTRATING THAT IMPLEMENTING SFAS-106 RESULTS IN AN EXOGENOUS COST CHANGE FOR TBO AMOUNTS UNDER THE COMMISSION'S PRICE CAP RULES?

BACKGROUND

In January of 1993, the Commission issued an order precluding LECs from increasing their Price Cap Indices (PCIs) to take account of alleged exogenous costs due to the implementation of SFAS-106 accounting practices for other post retirement benefits (OPEBs).[3] In the OPEB Order, the Commission defined a two-prong test to determine whether Generally Accepted Accounting Principle (GAAP) changes merited exogenous treatment. The first prong deals with the issue of whether LECs have the ability to control the costs associated with GAAP changes. If the LEC can control these costs, exogenous treatment is not warranted, since it would destroy the incentives for efficiency designed in the price cap system. The second prong of the test determines whether the existing price cap formula already contemplates such costs, either in the GNP-PI, the productivity factor, the initial rate of return, or in the formula as a whole. In the OPEB Order, the Commission correctly concluded that carriers had significant ability to control the going-forward "costs" associated with SFAS-106 accounting, and that exogenous treatment of such expenses was not warranted. The Commission indicated that the control issue was somewhat less clear for the transitional benefit obligation (TBO).

[3]Treatment of Local Exchange Carrier Tariffs Implementing Statement of Accounting Standards, "Employers Accounting for Postretirement Benefits Other Than Pensions," CC Docket No. 92-101, 8 FCC Rcd 1024 (1993) (OPEB Order).

However, the Commission clearly stated the carriers failed to meet their burden regarding the second prong of the test.[4]

Clearly the decision as to whether even accounting changes associated with the TBO alone merit exogenous treatment rests with the LEC's ability to demonstrate through the two-pronged test that these changes are exogenous cost changes. To meet this hurdle, it is incumbent upon the LECs to show that they have no control over the costs associated with a change in accounting practices, and that no aspect of the price cap formula allows LECs to double recover these costs. MCI will demonstrate below that the LECs have fallen short of this hurdle.

THE DIRECT CASES IN GENERAL

For the most part, carriers argue that they have indeed met the first prong of the test. Despite the fact that their support material from their existing OPEB plans generally states that the LECs maintain the right to modify or terminate these benefits, the LECs assert they do not have the ability to control the level of benefits for various reasons (eg., labor union contract obligations, public relations, implicit contracts with employees, etc.). Additionally some LECs state that they have little, if any control over the costs of these OPEBs because they have achieved these savings to the maximum already. The LECs further appear to argue that costs are not relevant, that the mere fact that SFAS-106 was promulgated by the Financial Accounting Standards Board (FASB) and was adopted for accounting principles by the Commission is the sole evidentiary requirement for exogenous treatment.

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[4]Ibid., at 1034.

No carrier has made a sound showing that SFAS-106 accruals for the TBO pass the first prong of the Commission's test. In the first part, these accruals are not costs for the purposes of price cap regulation. SFAS-106 merely changes the recognition of costs, not the actual costs themselves. Carriers under price caps will be no worse off under SFAS-106 than they would be in its absence. More importantly, since SFAS-106 does not change the actual expenditures of the LECs, there is no additional reason why existing LEC OPEB plans, or their recipients, are threatened. In the second part, carriers have not demonstrated that they lack control over the underlying costs associated with OPEBs. Most confuse the level of benefits with the costs of providing those benefits. In fact, in a letter attached to SWBT's Direct Case[5] the Communications Workers of America admit that they have exchanged lower wages and pensions (both endogenous) for retention of the OPEBs. The LECs therefore have the capability of trading OPEB costs with other endogenous costs, and they will continue to have the ability to pursue OPEB cost efficiencies as progress is made in the health care industry and as medical technology advances. To allow exogenous treatment of even the TBO would remove the incentives for the LEC to continue to press for more efficiencies in this arena, or would allow the LECs to trade exogenous and endogenous costs.

As important in the SFAS-106 issue is the second prong of the test for exogenous costs. As the Commission indicated, the existing record failed to demonstrate that the LECs had met their burden of proving the TBO is not double counted within the price cap formula or its component parts. Based upon the direct cases filed, no party has

[5]SWBT Direct Case, Appendix F. Letter from Victor C. Crawley, Vice President, Communications Workers of America, to FCC Commissioner Quello, June 18, 1993.

advanced any new information that identifies quantitatively the double counting issues (other than the flawed GNP-PI estimates from the Godwins study). For the most part the LECs stand by their existing filings, or alternatively suggest that double counting in the rate of return, intertemporally in the price cap formula itself, or in the productivity factor are either de minimis or nonexistent. Since the Commission has already determined that the existing record falls short of the LEC's burden in the double count issue, exogenous treatment for the TBO should be disallowed.

The issue of SFAS-106 within the context of price caps has been especially thorny. One of the key reasons for this is the fact that SFAS-106 merely designates accrual accounting over cash accounting. While this is useful for financial reporting purposes, the basic fact is that there is no real cost change. So from the outset there has been a great deal of confusion regarding its impact on price cap carriers. Furthermore, the regulatory scheme of price caps essentially indexes LEC revenue to its historical long run costs. The vast majority of American industry, for which SFAS-106 was designed, does not have revenues indexed to costs, so the treatment of changes in the time recognition of costs, as exemplified by SFAS-106 becomes different for price cap carriers. Since price cap LEC revenue has already been adjusted to grow with costs, to allow LECs additional recovery for accruals at this time would imply intertemporal double recovery of costs.

THE DIRECT CASE OF AMERITECH

Ameritech seeks to argue that the technical legal authority to modify its benefit plans should not determine whether these are exogenous costs. Ameritech contends that

SFAS-106 costs were to be based only on historical and anticipated obligations, not solely legal ones.[6] In fact, Ameritech's own documentation on its OPEBs clearly state that the company reserves the right to terminate these programs for retirees.[7] Unfortunately, Ameritech does little but offer some sort of amorphous test of control based upon "ethics, labor, and public relations impacts."[8] These factors would form a weak basis for the determination of exogenous costs in general, and SFAS-106 costs specifically. As such, Ameritech's direct case does little to prove that it has no control over costs associated with the accounting changes proposed under SFAS-106. Moreover, Ameritech appears to automatically equate the costs of its OPEBs with the benefits. Ameritech shows no evidence that the costs associated with OPEBs could not be reduced through more efficient provisioning options, managed health care programs, or future national health care policies.

Regarding double counting within the price cap formula, Ameritech admittedly offers no new evidence on its behalf. It suggests that its previous filings have dealt with this question, despite the Commission's own contention that the double counting issue has not been sufficiently addressed.[9] Ameritech has therefore not addressed the Bureau's concerns as discussed in the MO&O.

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[6]Ameritech Direct Case at 2.

[7]Ameritech Direct Case, Attachment 1, Exhibit 1, page 2 of 6.

[8]Ameritech Direct Case at 3.

[9] MO&O at ¶ 29.

THE DIRECT CASE OF BELL ATLANTIC

Like others in this proceeding, Bell Atlantic argues that it is legally precluded from altering the level of benefits afforded its current retirees. It is only for that portion of the TBO, for current retirees, that Bell Atlantic requests SFAS-106 exogenous treatment. Unfortunately, Bell Atlantic does not discuss the costs of the retirement program, but only the benefits allowed under its program. Whether a court would find that Bell Atlantic can modify post retirement health benefits for existing retirees is not the whole question, although like Ameritech, Bell Atlantic's own documentation on its plan clearly states that it reserves the right to make changes to its post retirement health insurance plans. The issue is whether Bell Atlantic has some ability to control the costs associated with the provision of benefits, and whether the automatic exogenous treatment of these costs would remove the incentives inherent within the Commission's price cap program. Moreover, it is clear from Bell Atlantic's documentation that its 1992 labor agreement significantly changed the arrangement agreed to in the 1989 agreement.[10] Obviously these plans can be modified, and the corporation apparently has some opportunities to review cost levels for these plans. Given this ability to modify plans, it would be imprudent to offer Bell Atlantic exogenous cost treatment for this select subset of its labor expenses. With exogenous treatment, Bell Atlantic would face no incentive to reign in, as best possible, OPEB expenses.

With regard to a discussion of any sort of double counting within the price cap formula, Bell Atlantic covers no new ground, reiterating arguments made in its filings

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[10]See Bell Atlantic Direct Case, Exhibit 2.

in July of 1992, and subsequently rejected as unsatisfactory in the 1993 OPEB Order. Since Bell Atlantic has offered nothing new in its defense, the Commission should correctly find that the exogenous treatment of theses costs would be inappropriate.

THE DIRECT CASE OF BELLSOUTH

BellSouth makes perhaps the most outrageous contentions of any LEC in these direct cases, claiming that LEC control over the OPEB costs is not relevant for determining whether the costs should be considered exogenous.[11] BellSouth suggests that the Commission has missed the point, that since the LECs had no control over the FASB decision to adopt accrual accounting for OPEBs, and had no control over the Commission's decision for LECs to adopt SFAS-106 for accounting purposes, these costs are definitively exogenous. These points have already been decided by the Commission, which correctly pointed out that LECs have significant control over ongoing OPEB costs and while the FASB and Commission decisions on SFAS-106 accounting might be outside the carrier's control, the costs themselves are not. BellSouth, in its discussion of price cap formula double counting, the second prong of the exogenous cost test, stands by the Godwins and NERA studies already found lacking by the Commission.

THE DIRECT CASE OF NYNEX

NYNEX fills much of its direct case, like many other LECs, rearguing the issues already decided within the Commission's OPEB Order. Rather than accede to the

[11]Direct Case of Bell South, pp. 2-5.

Commission's decision on the two-prong test of whether SFAS-106 merits exogenous cost treatment, NYNEX still maintains that since it had no control over the accounting decision made by both FASB and the Commission, the SFAS-106 changes are exogenous.[12] NYNEX further suggests that its incentives to control costs under endogenous treatment are illusory, maintaining that there is absolutely no way it can control the costs of OPEBs for future retirees.[13] NYNEX continues to attempt to confuse the distinction between health care benefits and services provided by OPEBs, and the costs of providing those services.

In an effort to rewrite the regulatory book on price caps, NYNEX makes the erroneous statement that:

> Under FCC Price Cap rules, if a GAAP change has been ordered by the FCC to be reflected in regulatory accounting, exogenous treatment should be granted to the extent there would be no double counting of costs in, e.g., the GNP-PI.[14]

This assumes, of course, that the GAAP change leads to a clear change in the underlying costs of providing telecommunications services. However, in this case, there is no clear cost change. SFAS-106 merely alters the recognition and accounting of OPEB costs, but does not by itself change the actual level of these costs over time. SFAS-106 does not mandate that LECs offer higher (or lower) OPEBs than they currently do (unlike some type of national health reform laws). SFAS-106 only states that companies provide their investors with realistic estimates of the total liability outstanding under current OPEBs.

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[12]NYNEX Direct Case, Exhibit 1, p.1-2.

[13]NYNEX Direct Case, Exhibit 1, p.17.

[14]Ibid., p.11.

SFAS-106 does not change the cash flow, nor otherwise change the underlying cost structure of the local exchange industry. A current liability to pay benefits at a future time is merely formalized for financial accounting purposes.

Moreover, SFAS-106 does not, in any way, change the legal and/or social framework for offering OPEBs. Denial of exogenous treatment for SFAS-106 will in no way undermine the LEC's ability to offer OPEBs to current or future retirees, nor does it impact in any way the legal requirements under such programs. LEC implications to the contrary merely serve to extort the Commission into providing exogenous treatment to an accounting change that does nothing to alter the underlying long run economic costs of providing telecommunications service. Exogenous treatment for SFAS-106 will not further guarantee OPEBs any more than any other form of labor compensation.

In its direct case, NYNEX claims that it has no control over the TBO costs for current retirees. In support of this statement, NYNEX contends that: the accounting change was mandated by FASB and the Commission; that past service for current retirees is already completed, therefore NYNEX must, by FASB standards, accrue for the benefits earned during this service; NYNEX has no control over the costs of TBO represented in its filing; and , NYNEX has already done all the cost containment possible with regards to current retiree OPEBs. NYNEX ends its argument with the veiled threat that denial of exogenous treatment would endanger its retirees OPEBs.[15] NYNEX does not justify why the appropriate denial of a $8 million annual cost item would generate a groundswell of shareholder outrage aimed at retirees.

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[15]Ibid., p.21.

Regarding issues of double counting, NYNEX attempts to place its own spin on the Commission's findings. NYNEX suggests that the supplemental study by Godwins filed in the 1993 Annual Access Tariff Filing of NYNEX (and other LECs) "fully addressed and resolved the deficiencies identified by the Commission."[16] NYNEX derives this finding, by stretching the Commissions finding in the MO&O that "[t]he record concerning double counting in the GNP-PI has been enhanced by a second Godwins study."[17] In actuality, such a statement is neutral, implying neither that GNP-PI double counting was correctly, or incorrectly analyzed. The Commission, despite NYNEX's editorializing, has not determined whether it has reversed its earlier finding that the amount of double counting within the GNP-PI is unclear.[18] The basic faults underlying the Godwins study still exist, despite the supplemental study's provision of further "what-if" calculations.

In terms of the issues raised by NYNEX in its discussion of the intertemporal double counting, NYNEX clearly misses the point. NYNEX suggests that by excluding the TBO from "GNP-PI minus X" treatment in the price cap formula, double counting will be resolved. This is totally untrue. Pay-as-you-go expenses have been embedded in the LEC pre-price cap costs, and were incorporated in whole at the start of price caps. Moreover, the price cap formula allows for a continuation of the relationship between LEC revenues and LEC costs. Revenues are allowed to grow by the GNP-PI factor, as

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[16]Ibid., p. 22.

[17]MO&O, ¶ 29.

[18]OPEB Order, at 1035.

adjusted for productivity, to ensure that revenues grow in the same relationship as costs. By indexing LEC revenues to inflation, the Commission has also indexed all underlying costs for inflation. In the long run, absent any incentive-driven cost reductions by the LECs, one would expect that returns for LECs to remain constant. Future OPEB payments would be funded through the indexed growth in revenues. This is exactly the "rough justice" afforded to LECs under price caps. To reward LECs for the accrual of future pay-as-you-go amounts already embedded within the indexation of their revenues and costs would be tantamount to double recovery of these expenses.

A second double count that NYNEX wishes to dismiss, without regards to Commission findings, is the double count inherent in the rate of return underlying price caps. Investor uncertainty regarding the total LEC liability for OPEBs, the impact this would have on operations, and the ability of LECs to fully recover such expenses could have resulted in higher than otherwise cost of equity measures in the last rate of return represcription.[19] If this were the case, LECs have already received added recovery based on this upward bias. NYNEX, however, wishes to totally disregard the theory of efficient markets and Discounted Cash Flow (DCF), upon which the Commission's rate of return represcription methodology was based. Rather than offer actual empirical evidence to prove that the stock market took no account of impending and largely unknown SFAS-106 liabilities, NYNEX merely seeks to distort what is actually on the record. Citing a study by Mittlestaedt and Warshawsky, NYNEX claims that there was no impact on stock prices from SFAS-106. NYNEX, however, cites merely from an

[19]OPEB Order, at 1036.

abstract of the original study, and ignores the actual findings of the study.[20] In their study, Mittlestaedt and Warshawsky found that stock valuations were reduced by approximately 50 percent of the value of the outstanding SFAS-106 liability.[21] The authors of this study proposed that since many issues were uncertain regarding actual SFAS-106 liabilities, the probability of corporations altering their level of OPEBs, and the ability of the Federal Government to reach consensus on health care reform, the expected theoretical impact of a one for one reduction in market valuation did not occur. There was no question, however, that the effect of SFAS-106 on share prices was of the correct direction and a reasonable magnitude. Not only does this finding leave NYNEX's analysis incorrect, but it also provides evidence of its counter-claim that SFAS-106 would leave share prices unaffected because of secondary impacts on dividend growth expectation.[22]

Regarding other sources of double counting, NYNEX does not augment the record, rather it dismisses the notion without any full and reasoned analysis. NYNEX has clearly not met its burden of establishing that no double counting exists between the components of the price cap formula and its exogenous cost request.

THE DIRECT CASE OF PACIFIC BELL

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[20]NYNEX Direct Case, Exhibit 1, p.27, note. 42.

[21]Treatment of Local Exchange Carrier Tariffs Implementing Statement of Accounting Standards, "Employers Accounting for Postretirement Benefits Other Than Pensions," CC Docket No. 92-101, MCI Opposition to Direct Cases, filed July 1, 1992, Appendix A, affidavit of Professor Allan Drazen.

[22]One must remember that SFAS-106 was designed as a one-time recognition of accrued liabilities, and by itself did not create costs. As such investors could reasonably expect that long term earnings growth would be relatively unaffected, thereby causing share prices to decline under the DCF methodology.

Pacific Bell, in its direct case, does not augment the record on SFAS-106 costs, but rather reargues the issue of the definition of exogenous. Like other LECs, Pacific maintains that SFAS-106 costs are exogenous, since it had no control over FASB in its decision to rule for accrual accounting of OPEBs. Pac Bell paints the extreme case that the OPEB Order leads to the conclusion that no change can be exogenous, since LECs always maintain some level, no matter how small, over these changes.[23] Unfortunately, the direct cases are not the proper venue for seeking reconsideration the OPEB Order. Pac Bell offers no new reasoning for the extension of exogenous treatment for the TBO portion of SFAS-106 accruals.

THE DIRECT CASE OF SOUTHWESTERN BELL

SWBT raises a variety of issues within its lengthy direct case on the issue of SFAS-106 costs. SWBT argues, for example, that it had no control over the FASB ruling, no control over the Commission's decision to adopt SFAS-106 accounting, no control over the results of collective bargaining, and no control over the fact that its initial rates under price caps did not include SFAS-106 accounting costs.

Apparently, however, SWBT has no control over its rhetoric on this issue as well. SWBT is mistaken in its belief that price cap carriers should be awarded exogenous treatment of all GAAP changes, solely on the basis that it had no control over the adoption of a rule change. The Commission has clearly stated that changes in LEC costs

[23]Pacific Bell Direct Case, p.4

driven by GAAP changes may be considered exogenous.[24] Since SFAS-106 does not change costs, and only formalizes recognition of estimates of future liabilities, there is no need to allow LECs to double recover these amounts. What must be distinguished is whether the carrier has reasonable control over the results of that decision, and whether that decision produces a change in the underlying cost and revenue structure contained within the price cap system. SWBT, in its Direct Case, even states directly that these liabilities are not new, but have been "economic reality all along."[25] MCI wishes to remind the Commission that the price cap system was designed as an alternative form of regulation that produces incentives for carriers to become efficient and to have the possible rewards of larger earnings. In that regard, carriers are expected to respond to changes in the economy, and make cost-efficient decisions. Carriers were not thrown into a world of completely free enterprise. Rather, carriers were permitted to index their rates to inflation, have a certain degree of pricing flexibility, but were allowed to receive benefits in line with the minimal risks of the price cap program. Under SWBT's opinion, carriers should be permitted to revisit their price cap indices whenever some new occurrence, that may or may not have actual financial and economic consequences, has been promulgated by governmental or standards bodies.

The crucial questions posed by the Commission is not whether SFAS-106 is avoidable. Rather, the first question is whether the costs associated with accrual accounting for OPEBs are actual costs for which carriers have no options to avoid.

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[24]Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd. 6786 (1990) (LEC Price Cap Order), ¶ 168.

[25]SWBT Direct Case, p.31.

SWBT has not made a convincing showing in this regard. First, SWBT, nor any other LEC for that matter, has demonstrated that the costs associated with the institution of accrual accounting are real to the firm. While accrual accounting does create a liability on the balance sheet, there is no cash outflow, and the accrual recognizes only that liability that had been there all along. The Commission has already recognized that OPEB liabilities for future employee work-years are part of a total package of compensation, the amount and mix of which is clearly controlled by the LEC. In regards to the TBO, carriers have not demonstrated that control over the costs associated with OBEPs are beyond their control. While SWBT claims that it cannot unilaterally change benefits, it has not demonstrated that it has no ability to either control the costs of providing OPEBs for its current or future retirees, nor has it demonstrated that it would be impossible to alter the mix of pension and non-pension benefits to satisfy collective bargaining parties. If, for example SWBT was granted exogenous treatment for OPEBs, SWBT would be able to game the system by offering more OPEBs, or reducing retiree co-payments of premiums, at the expense of pension payments. In fact, in a letter attached to SWBT's Direct Case[26] the Communications Workers of America admit that they have exchanged lower wages and pensions (both endogenous) for retention of the OPEBs. If the Commission were to grant exogenous treatment for SFAS-106 accrual accounting for the TBO, the same issues would be raised that led to the rejection of exogenous treatment for non-TBO accruals.[27] Moreover, any cost savings associated

[26]SWBT Direct Case, Appendix F. Letter from Victor C. Crawley, Vice President, Communications Workers of America, to FCC Commissioner Quello, June 18, 1993.

[27]OPEB Order, at 1037.

with better managed care would simply be kept by SWBT, at the expense of lower access charges.

Second, SWBT claims that there are no more cost savings to achieve in its OPEB estimates. This self-serving argument only works in a frozen environment with no technological and medical advances. Right now health care is one of the foremost issues in the United States. Pressure is being brought to the health care industry to control costs and find more efficient means of treatment. Companies in competitive segments of the economy, who do not have the luxury of requesting exogenous price changes, will continue to seek ways to lower the costs of health insurance premiums. And SWBT, along with other LECs, will accrue benefits from this process. For SWBT to state that cost efficiencies in the health care industry have ceased is ludicrous.

SWBT simply can not logically argue the control issue both ways. On the one hand, SWBT maintains that it is unable to effect cost reductions on OPEBs, yet at the same time it has produced evidence that in the most recent past it has been able to reduce the costs of medical premiums through its benefit cap.[28] Clearly there is some level of control here, and SWBT has not provided significant evidence to the contrary.

The remainder of SWBT's arguments regarding the control issue are also groundless. SWBT maintains that had it known that it would be unable to elicit rate recovery for SFAS-106 accruals, it would have prefunded OPEBs through Voluntary Employees' Beneficiaries Associations (VEBA). However, it would have been virtually impossible for the Commission to preface price caps by a litany of detailed items that

[28]SWBT Direct Case, p.17.

would be guaranteed exogenous treatment. The Commission never promised that SFAS-106 would be granted exogenous treatment, and it is SWBT's burden that it chose alternative uses of funds that could have gone to VEBA. Under rate of return, SWBT was allowed to have reasonable total expenses and have net income sufficient to target its authorized rate of return. To complain now that it was not treated as fairly as other carriers that pre-funded OPEBs through VEBAs completely misses the point. Finally, SWBT suggests that it has pared down its filed estimate of the TBO by such an amount that windfalls from beating the assumptions would be virtually impossible.[29] It contemplates that if granted exogenous treatment there would be little likelihood that SWBT would be able to beat the conservative assumptions used in the filing package.[30] This issue succinctly illustrates the issue of control: if carriers are granted exogenous treatment, there is little incentive to pursue efficient health care. Or, on the other hand, carriers can attempt to make windfalls by merely beating the assumptions underlying the SFAS-106 accrual estimates and retain these excessive earnings.[31]

With regards to the possible double counting issues, SWBT raises no new points. While it offers both theoretical and anecdotal reasons why stock prices might not have been lowered prior to the formal SFAS-106 announcement, it offers no empirical evidence which refutes the Warshawsky study showing that stock valuations did indeed

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[29]SWBT Direct Case, p. 21-2.

[30]Ibid., p.24.

[31]It is important to remember here that SFAS-106 guidelines have a relatively high threshold for requiring firms to change accrued liabilities due to alterations to the calculations and the assumptions underlying them.

fall prior to SFAS-106. Rather than attempt to augment the record in this regard, SWBT merely wishes to rehash the record.

SWBT does, however attempt to address the Commission's observation that the current price cap system, since it has the pay-as-you-go amounts embedded in the initial rates and these are treated through the GNP-PI - X factor, already programs the price cap system to compensate carriers for OPEB expenses.[32] SWBT presents a simplified example which purports to show that under exogenous treatment, carriers will receive more "cost" recovery than under the existing price cap system.[33] What SWBT fails to point out in its example is the last column, SFAS-106 expense, is not a real expense, but rather an accounting accrual. The present value of that column is greater than the pay-as-you-go column, but only because non-cash accounting entries are made in the early years. These are not expenses, as SWBT maintains, but rather bookkeeping entries that sum to the exact same value as the pay-as-you-go amount. Moreover, what is illustrated by the difference between the two present values is the excess amount of funds, based on opportunity costs, SWBT will have at its disposal if it is able to have rate increases for exogenous SFAS-106 accruals.

THE DIRECT CASE OF US WEST

US West, in its direct case, takes the position the it has presented sufficient evidence to demonstrate that SFAS-106 accruals for the TBO should be treated as

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[32]OPEB Order at 1035.

[33]SWBT Direct Case, p. 38.